Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Saldana	Analyst:	Gail Hall	Bill Number:	AB 838
Related Bills:	See Legislative History	Telephone:	845-6111	Introduced Date:	February 18, 2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Hybrid Or Alternative Fuel Vehicle Annual License Fees Credit

SUMMARY

This bill would create a tax credit for taxpayers that purchase fuel-efficient vehicles.

PURPOSE OF THE BILL

According to the author's office, this bill is intended to provide taxpayers with an incentive to purchase fuel-efficient, environmentally-friendly vehicles.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon signature and apply to taxable years beginning on or after January 1, 2005, and ending on or before December 31, 2012.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Federal law provides a tax credit for the purchase of a qualified electric vehicle. The maximum credit is $4,000 and is gradually phased out beginning in tax year 2004. Qualified electric vehicles placed in service after December 31, 2006, do not qualify for the credit.

Annually, California charges individuals and businesses a motor vehicle registration fee on the ownership of motor vehicles. The state Department of Motor Vehicles (DMV) administers the fee. The motor vehicle registration fee is made up of a vehicle license fee (VLF), base registration fee, and other miscellaneous fees.

Current federal and state laws allow individuals to deduct certain expenses, such as medical expenses, charitable contributions, mortgage interest, and taxes, such as the VLF, as itemized deductions. The VLF is considered a personal property tax based on the market value of the motor vehicle.

Board Position:			Department Director	Date
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Current federal and state laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. Thus, the motor vehicle registration fee paid on a vehicle used in a trade or business is an allowable business deduction.

PROGRAM BACKGROUND

The California Air Resources Board (CARB) gathers air quality data for the State of California, ensures the quality of this data, designs and implements air models, and sets air quality standards for the state. CARB is a part of the California Environmental Protection Agency, an organization that reports directly to the Governor.

Listed below are emission ratings established by CARB:

1. Low-Emission Vehicle (LEV) – All new cars sold in California starting in 2004 will have at least a LEV or better emissions rating.

2. Ultra Low-Emission Vehicles (ULEV) – Cars that are 50% cleaner than the average new 2003 model year car receive an ULEV emissions rating.

3. Super Ultra Low-Emission Vehicle (SULEV) – Cars that are 90% cleaner than the average new 2003 model year car receive a SULEV emissions rating.

4. Partial Zero Emission Vehicle (PZEV) – Cars that meet the SULEV emission standards, have zero evaporative emissions, and have a 15 year/150,000 mile warranty on emissions equipment, will receive a PZEV emissions rating.

5. Advanced Technology PZEV (AT PZEV) – Cars that meet the PZEV requirements and have additional “ZEV-like” characteristics receive an AT PZEV emissions rating. A dedicated compressed natural gas vehicle, or a hybrid vehicle with engine emissions that meet the PZEV standards, would have an AT PZEV rating.

6. Zero Emission Vehicles (ZEV) – These cars have zero tailpipe emissions and are 98% cleaner than the average 2003 model year vehicle. Examples include the battery electric vehicle and hydrogen fuel cell vehicles.

<u>THIS BILL</u>

This bill would allow individuals and businesses that purchase “qualified vehicles” a tax credit equal to the amount of the VLF paid annually to register one of these vehicles.

A “qualified vehicle” means either of the following:

1. A hybrid vehicle or an alternative fuel vehicle that meets the AT PZEV emissions standard and has a _____miles per gallon or greater fuel economy highway rating.

2. A hybrid vehicle that meets the ULEV, SULEV, or PZEV emissions standards and has a _____miles per gallon or greater fuel economy highway rating.

The amount of tax credit that exceeds the taxpayer’s tax liability is not refundable, but instead, may be carried forward for use in future years without limitation.

This credit would remain in effect until January 1, 2013, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. The department does not possess the expertise necessary to determine which vehicles qualify for this credit. The author should consider having a third-party, such as DMV, certify which vehicles qualify for this credit.

LEGISLATIVE HISTORY

AB 1390 (Ridley-Thomas, 2003/2004) would have allowed a tax credit for the purchase of a new fuel-efficient vehicle if the Department of Finance certified that it found projected state revenues exceeded projected state expenditures. This bill remained in the house of origin.

AB 2484 (Ridley-Thomas, 2003/2004), AB 198 (Nation, 2003/2004), and AB 848 (Nation, 2003/2004) would have denied the general California business incentives relating to vehicles when a business purchased a large sport utility vehicle (SUV). The revenue from disallowing these incentives would have been used to fund a credit for the purchase and use of qualified reduced-emission vehicles in this state. AB 2484 was held in Assembly Appropriations, AB 848 remained in the house of origin, and AB 198 was held in Senate Appropriations.

OTHER STATES' INFORMATION

Florida, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws do not provide a credit comparable to the credit this bill would create. The laws of these states were reviewed because their tax laws are similar to California's tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs because the changes required by this bill could be accomplished during the department's annual update.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows:

Estimated Revenue Impact of AB 838 Effective Tax Years BOA 1/1/05 Assumed Enactment Date After 6/30/05 (In Millions)		
2005/06	2006/07	2007/08
-$5	-$15	-$30

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The revenue impact of this proposal is dependent on the number of qualified vehicles registered in California, the average VLF paid, and the average credit usage rate.

According to the DMV 42,000 hybrid vehicles are currently registered in California. Based on sales trends of the hybrid car market, total registered hybrids in California account for approximately 25% of the U.S. market. Historical data shows that sales of hybrids have, on average, doubled over the past five years. With the release of five new hybrid vehicles during 2005, U.S. sales are anticipated to continue to double, approximate 200,000 by 2006, and increase to 1.2 million by 2008.

It is estimated that 75,000 hybrid vehicles will be assessed the VLF during calendar year 2005. This total includes both prior purchases (approximately 42,000) plus new 2005 purchases. Therefore, two average VLF amounts are used. Per DMV, the average VLF is $70; this average was applied to the 42,000 hybrid vehicles currently registered. For vehicles purchased during 2005, recent legislation requires the VLF to reflect .65% of the vehicle's market value. The average price of a new hybrid vehicle is approximately $22,000. An adjustment is required so that the market value is comparable to a gas-only vehicle. The price difference approximates $3,000, and the average VLF for a new hybrid vehicle is estimated at $124 ($22,000 - $3,000) x .65%).

Based on the average VLFs discussed above, the anticipated significant growth in hybrid vehicle sales, and the anticipated tax liability that may be reduced by the credit, it is estimated that $5 million in credits will be used during fiscal year 05/06. This amount is expected to increase rapidly to $15 million for 06/07 and double to $30 million during fiscal year 07/08.

ARGUMENTS/POLICY CONCERNS

1. This bill would allow individuals and businesses to claim multiple tax benefits for the same item of expense. An individual may deduct the VLF as a state itemized deduction and also take this same amount as a state tax credit. A business may deduct the VLF as a business expense and also take this same amount as a state tax credit. The multiple tax benefit concern could be eliminated if hybrid vehicles were given an exemption from the VLF instead of a tax credit.

2. It is noted that this bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with no more than an eight-year carryover period since experience shows credits are typically used within that period of time.

LEGISLATIVE STAFF CONTACT

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